

# **Report of the auditor-general to the Free State Legislature and the council on the Mafube Local Municipality**

## **Report on the financial statements**

### **Introduction**

1. I was engaged to audit the financial statements of the Mafube Local Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2015, the statement of financial performance, statement of changes in net assets, cash flow statement and the statement of comparison of budget and actual amounts for the year then ended, as well as the notes, comprising a summary of significant accounting policies and other explanatory information.

### **Accounting officer's responsibility for the financial statements**

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2014 (Act No. 10 of 2014) (DoRA) and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

### **Auditor-general's responsibility**

3. My responsibility is to express an opinion on the financial statements based on conducting the audit in accordance with International Standards on Auditing. Because of the matters described in the basis for disclaimer of opinion paragraphs, however, I was unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

### **Disclaimer of opinion**

#### **Property, plant and equipment**

4. I was unable to obtain sufficient appropriate audit evidence regarding property, plant and equipment due to lack of an adequate asset management system. I was unable to confirm the assets by alternative means. Consequently, I was unable to determine whether any adjustments to property, plant and equipment stated at R1 044 127 738 (2014: R1 153 361 203) in note 4 to the financial statements were necessary. In addition, the municipality did not review the residual values and useful lives of infrastructure assets at each reporting date in accordance with SA Standards of GRAP, GRAP 17, *Property, plant and equipment* (GRAP 17). The municipality also did not capitalise all items of property, plant and equipment in accordance with GRAP 17 as

work in progress was incorrectly recognised. I was not able to determine the correct net carrying amount of infrastructure assets and work in progress as it was impracticable to do so. Additionally, there was a resultant impact on the deficit for the period and on the accumulated surplus.

### **Payables from exchange transactions**

5. I was unable to obtain sufficient appropriate audit evidence for trade payables, accrued leave pay, salary control accounts, income received in advance, and advance payables included in payables from exchange transactions due to the unavailability of reconciliations or support for these balances. I was unable to confirm the balances by alternative means. Consequently, I was unable to determine whether any adjustments to these balances stated at R102 307 022 (2014: R62 185 017) included in the amount of R274 867 634 (2014: R181 593 825) as disclosed in note 18 to the financial statements were necessary. In addition, differences were identified between the amounts disclosed in the financial statements and external confirmations as well as differences on debtors with credit balances. Consequently, payables from exchange transactions and expenditure were understated by R31 133 561 (2014: R5 959 048), respectively. There was also a resultant impact on the deficit for the period and the accumulated surplus.

### **Investment property**

6. The municipality did not value investment properties disclosed in note 3 to the financial statements in accordance with SA Standards of GRAP, GRAP 16, *Investment property*. The assumptions used in the investment property register were not accurately applied in the determination of the deemed cost. I was not able to determine the full extent of the misstatement as it was impracticable to do so.

### **Consumer receivables from exchange transactions**

7. I was unable to obtain sufficient appropriate audit evidence for consumer debtors due to several unexplained differences or supporting documents that could not be provided. Support could also not be provided for the calculation of the provision for impairment of debtors. I was unable to confirm consumer debtors by alternative means. Consequently, I was unable to determine whether any adjustments to consumer debtors stated at R63 954 782 (2014: R35 926 954) in note 11 to the financial statements were necessary.

### **Receivables from non-exchange transactions**

8. The municipality did not calculate the debt impairment for receivables from non-exchange transactions in terms of SA Standards of GRAP, GRAP 104 *Financial instruments*. The municipality did not take the payment history of debtors into account. I was unable to determine the full extent of the misstatement as it was impracticable to do so. There was also a resultant impact on the deficit for the period and the accumulated surplus. In addition, sufficient appropriate audit evidence could not be obtained for the process followed for the calculation of debt impairment for the prior year. Consequently, I was unable to determine whether any further adjustments to the provision for debt impairment stated at R19 172 701 (2014: R15 091 223) in note 10 to the financial statements were necessary.

## **Property rates**

9. I was unable to obtain sufficient appropriate audit evidence for property rates due to differences between the chargeable rates per the valuation roll, the accounting records and the financial statements that could not be supported. I was unable to confirm the property rates by alternative means. Consequently, I was unable to determine whether any adjustments to property rates stated at R21 152 561 (2014: R19 474 278) in note 23 to the financial statements were necessary.

## **Unauthorised expenditure**

10. The municipality did not include particulars of all unauthorised expenditure and did not adhere to the disclosure requirements in note 47 to the financial statements as required by section 125(2)(d)(i) of the MFMA. The municipality incurred expenditure in excess of the approved budget which was not disclosed as unauthorised expenditure, with the result that unauthorised expenditure was understated by R81 078 668 (2014: R120 573 266).

## **Irregular expenditure**

11. The municipality did not include particulars of all the irregular expenditure incurred in the notes to the financial statements, as required by section 125(2)(d)(i) of the MFMA. The municipality made payments in contravention of the Supply chain management regulations which were not included in irregular expenditure, with the result that irregular expenditure was understated by R16 715 209 (2014: R13 260 890). I was not able to determine the full extent of the misstatement as it was impracticable to do so. In addition, during 2012-13 irregular expenditure was written off without proper investigations having been performed. This resulted in a further understatement of the closing balance of irregular expenditure by R71 142 949 (2014: R71 142 949).

## **Commitments**

12. I was unable to obtain sufficient appropriate audit evidence for capital commitments due to an inadequate contract management system and incomplete contract register. I was unable to confirm the disclosure by alternative means. Consequently, I was unable to determine whether any adjustments to commitments stated at R40 113 980 (2014: R58 207 711) as disclosed in note 41 to the financial statements were necessary.

## **Fruitless and wasteful expenditure**

13. The municipality did not include particulars of all the fruitless and wasteful expenditure incurred in note 48 to the financial statements, as required by section 125(2)(d)(i) of the MFMA. I was not able to determine the full extent of the misstatement as it was impracticable to do so. In addition, fruitless and wasteful expenditure was written-off during 2012-13 without proper investigations having been performed. This resulted in an understatement of the closing balance of fruitless and wasteful expenditure by R17 727 744 (2014: R17 727 744).

## Comparison of budget and actual amounts

14. The municipality did not disclose the final approved adjustment budget figures in the financial statements in accordance with SA Standards of GRAP, GRAP 24, *Presentation of budget information in financial statements* (GRAP 24). I identified various material differences between the disclosed budgeted amounts and the final adjustment budget, resulting in the figures disclosed the statement of comparison of budget and actual amounts being materially misstated.

## Public-private partnership

15. The municipality did not disclose information regarding the public private partnership between the municipality and the electricity service provider as required by International Financial Reporting Interpretations Committee (IFRIC) 12, *Service concession arrangements*.

## Prior period errors

16. The municipality did not disclose the reclassification of comparative figures and prior period errors as required by SA Standards of GRAP, GRAP 1, *Presentation of financial statements* and GRAP 3, *Accounting policies, changes in accounting estimates and errors*. Details of all the corresponding figures that were reclassified or restated since the prior year were not disclosed under prior period errors in note 44 to the financial statements.

## Financial instruments

17. The amount disclosed as financial instruments in note 21 to the financial statements does not include payables from exchange transactions of R274 867 634. The prior year balance is stated as R156 923 846, while in note 18 payables from exchange transactions is stated as R181 593 825. Payables from exchange transactions are therefore understated by R274 867 634 (2014: R24 669 979) in note 21 to the financial statements.

## Aggregation of immaterial uncorrected misstatements

18. The financial statements were materially misstated due to the cumulative effect of numerous individually immaterial uncorrected misstatements in the following items included in the statement of financial position and the statement of financial performance:
  - Service charges and consumer receivables from exchange transactions in respect of sale of water reflected as R31 294 060 and R25 524 392, respectively, was overstated by R6 385 796.
  - Revenue from service charges and expenditure related to transfers and subsidies reflected as R61 461 665 (2014: R48 865 840) and R3 547 907 (2014: R6 746 501), respectively, was overstated by R3 547 907 (2014: R6 746 501).
  - VAT payable and consumer receivables from exchange transactions reflected as R9 317 657 (2014: R13 388 504) and R63 954 782 (2014: R35 926 954), respectively, was understated by R4 910 203 (2014: R4 204 476).
  - Net cash flows from operating activities reflected as R28 436 976 was understated by R4 788 975.

- Material losses was not disclosed in the notes to the financial statements as required by section 125(2)(d)(i) of the MFMA.
19. In addition, I was unable to obtain sufficient appropriate audit evidence and to confirm the following items by alternative means:
- Receivables from non-exchange transactions of R9 545 775 as included in the disclosed balance of R25 382 329 (2014: R18 786 910) as disclosed in note 10.
  - VAT payable of R8 601 998 as included in the disclosed balance of R9 317 657 (2014: R13 388 504) as disclosed in note 19.
  - Pension fund and medical aid deductions of R9 068 231 as included in the disclosed balance of R19 222 043 (2014: R10 453 233) as disclosed in note 50.

### **Going concern**

20. The municipality did not disclose the going concern risk as required by GRAP 1, Presentation of financial statements in the notes to the financial statements. A number of indicators exist that indicates that the municipality is experiencing financial difficulty. These include a high level of impairment of its consumer debtors, current liabilities that exceed current assets by R218 865 471 and the deficit amounting to R152 069 288 as disclosed in the financial statements. The potential negative effect of this tendency on the cash flows of the municipality and the inability to settle accounts payable within an acceptable period also indicates uncertainty. The municipality did not disclose any details of the uncertainty in the financial statements.

### **Disclaimer of opinion**

21. Because of the significance of the matters described in the basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on the financial statements.

### **Emphasis of matters**

22. I draw attention to the matters below. My opinion is not modified in respect of these matters.

### **Material impairments**

23. As disclosed in notes 10 and 11 to the financial statements, a provision for impairment of consumer debtors and receivables from non-exchange transactions amounting to R211 717 607 (2014: R167 653 049) were made as a result of irrecoverable debtors.

## **Additional matter**

24. I draw attention to the matter below. My opinion is not modified in respect of this matter.

### **Unaudited disclosure notes**

25. In terms of section 125(2)(e) of the MFMA the municipality is required to disclose particulars of non-compliance with the MFMA. This disclosure requirement did not form part of the audit of the financial statements and accordingly I do not express an opinion thereon.

## **Report on other legal and regulatory requirements**

26. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof, I have a responsibility to report findings on the reported performance information against predetermined objectives for selected key performance areas presented in the annual performance report, compliance with legislation and internal control. The objective of my tests was to identify reportable findings as described under each subheading, but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on these matters.

## **Predetermined objectives**

27. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected key performance areas (KPA's) presented in the annual performance report of the municipality for the year ended 30 June 2015:

- KPA 4: Basic service delivery on pages xx to xx
- KPA 6: Planning, service delivery and infrastructure development on pages xx to xx

28. I evaluated the reported performance information against the overall criteria of usefulness and reliability.

29. I evaluated the usefulness of the reported performance information to determine whether it was presented in accordance with the National Treasury's annual reporting principles and whether the reported performance was consistent with the planned key performance areas. I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's *Framework for managing programme performance information* (FMPPI).

30. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.

31. The material findings in respect of the selected key performance areas are as follows:

## **KPA 4: Basic service delivery**

### Usefulness of reported performance information

32. The FMPPPI requires the following:

- Performance targets should be specific in clearly identifying the nature and required level of performance. In total, 70% of the targets were not specific.
- Performance targets should be measurable. I could not measure the required performance for 70% of the targets.

This was because management did not adhere to the requirements of the FMPPPI and a lack of proper systems, processes and technical indicator descriptions.

### Reliability of reported performance information

33. The FMPPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of the reported performance information. This was due to limitations placed on the scope of my work due to the absence of information systems, the fact that the auditee could not provide sufficient appropriate evidence in support of the reported performance information and the auditee's records not permitting the application of alternative audit procedures.

## **KPA 6: Planning, service delivery and infrastructure development**

### Usefulness of reported performance information

34. The FMPPPI requires the following:

- Performance targets should be specific in clearly identifying the nature and required level of performance. In total, 83% of the targets were not specific.
- Performance targets should be measurable. I could not measure the required performance for 83% of the targets.

This was because management did not adhere to the requirements of the FMPPPI and a lack of proper systems, processes and technical indicator descriptions

### Reliability of reported performance information

35. The FMPPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of the reported performance information. This was due to limitations placed on the scope of my work due to the absence of information systems, the fact that the auditee could not provide sufficient appropriate evidence in support of the reported performance information and the fact that the auditee's records did not permit the application of alternative audit procedures.

## **Additional matter**

36. I draw attention to the following matter:

### **Achievement of planned targets**

Refer to the annual performance report on pages x to x and x to x for information on the achievement of planned targets for the year. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information for the selected key performance areas reported in paragraphs 31 to 34 of this report.

## **Compliance with legislation**

37. I performed procedures to obtain evidence that the municipality had complied with applicable legislation regarding financial matters, financial management and other related matters. My material findings on compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA, are as follows:

### **Annual financial statements**

38. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements identified by the auditors in the submitted financial statements were not adequately corrected and the supporting records could not be provided subsequently, with the result that the financial statements received a disclaimer of audit opinion.

### **Audit committee**

39. The audit committee did not submit, at least twice during the financial year, an audit report on the review of the performance management system to the council, as required by *Municipal planning and performance management regulation 14(4)(a)(iii)*.

### **Human resource management**

40. The competencies of the senior managers were not assessed in a timely manner in order to identify and address gaps in competency levels as required by *Municipal regulations on minimum competency levels 13*.

41. The municipality did not develop and adopt appropriate systems (policies) and procedures to monitor measure and evaluate performance of staff in contravention of section 67(d) of the Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA).

### **Expenditure management**

42. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.

43. Reasonable steps were not taken to prevent unauthorised, irregular or fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

44. An adequate management, accounting and information system was not in place which recognised expenditure when it was incurred and accounted for creditors as required by section 65(2)(b) of the MFMA.



## **Revenue management**

- 45. An adequate management, accounting and information system which accounts for revenue was not in place, as required by section 64(2)(e) of the MFMA.
- 46. An effective system of internal control for revenue and debtors was not in place, as required by section 64(2)(f) of the MFMA.

## **Consequence management**

- 47. Unauthorised, irregular and fruitless and wasteful expenditure incurred by the municipality was not investigated to determine whether any person was liable for the expenditure, as required by section 32(2)(a)(ii) of the MFMA.

## **Procurement and contract management**

- 48. Sufficient appropriate audit evidence could not be obtained that goods and services with a transaction value of below R200 000 were procured by means of obtaining the required price quotations, as required by SCM regulation 17(a) and (c).
- 49. Quotations were accepted from prospective providers who were not registered on the list of accredited prospective providers and did not meet the listing requirements prescribed by the SCM policy in contravention of SCM regulation 16(b) and 17(b).
- 50. Sufficient appropriate audit evidence could not be obtained that goods and services of a transaction value above R200 000 were procured by means of inviting competitive bids, as required by SCM regulation 19(a).
- 51. Sufficient appropriate audit evidence could not be obtained that the preference point system was applied in all procurement of goods and services above R30 000 as required by section 2(a) of the Preferential Procurement Policy Framework Act, 2000 (Act No. 5 of 2000) and SCM regulation 28(1)(a).
- 52. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.
- 53. The contract performance and monitoring measures and methods were insufficient to ensure effective contract management, as required by section 116(2)(c) of the MFMA.

## **Conditional grants**

- 54. The Municipal Infrastructure Grant allocation was not spent in accordance with the applicable grant framework, in contravention of section 17(1) of the DoRA.
- 55. The municipality did not evaluate its performance in respect of programmes funded by the Municipal Infrastructure Grant and Municipal Systems Improvement Grant allocations, as required by section 12(5) of the DoRA.
- 56. Municipal Infrastructure Grant funds were retained or rolled over to the next financial year without seeking the approval of the National Treasury, as required by sections 22(1) of the DoRA.

## **Asset management**

- 57. An adequate management, accounting and information system which accounted for assets was not in place, as required by section 63(2)(a) of the MFMA.

58. An effective system of internal control for assets (including an asset register) was not in place, as required by section 63(2)(c) of the MFMA.

### **Strategic and annual planning process**

59. The local community was not afforded the opportunity to comment on the final draft of the integrated development plan (IDP) before adoption, as required by section 42 of the MSA and Municipal planning and performance management regulations 9, 13(1), 13(4)(c) and 15(3).
60. The municipality did not give effect to its integrated development plan and conduct its affairs in a manner which was consistent with its integrated development plan, as required by section 36 of the MSA, section 21(2)(a) of the MFMA and Municipal planning and performance management regulation 6.
61. The municipality did not establish a performance management system, as required by section 38(a) of the MSA.
62. The municipality did not establish mechanisms to monitor and review its performance management system, as required by section 40 of the MSA.
63. The performance of the municipality was not assessed during the first half of the financial year, as required by section 72(1)(a)(ii) of the MFMA.
64. Measurable performance targets for the financial year were not set in the IDP, for each of the key performance indicators and with regard to each of the development priorities or objectives, as required by section 41(1)(b) of the MSA and the Municipal planning and performance management regulations 12(1) and 12(2)(e).
65. The annual performance report for the year under review did not include a comparison with the previous financial year as required by section 46 (1)(b) of the MSA.
66. The performance management system and related controls were inadequate as they did not describe and represent the processes of performance monitoring, measurement, review and reporting and how they were conducted, organised and managed, as required by sections 38 of the MSA and regulation 7 of the Municipal planning and performance management regulations.
67. The annual performance agreements for the municipal manager and all senior managers were not linked to the measurable performance objectives approved with the budget and to the service delivery budget implementation plan as required in terms of section 53(1)(c)(iii) of the MFMA and section 57(1)(b) of the MSA.

### **Internal control**

68. I considered internal control relevant to my audit of the financial statements, the performance report and compliance with laws and regulations. The matters reported below under the fundamentals of internal control are limited to the significant deficiencies that resulted in the basis for the disclaimer of opinion and the findings on the performance report and compliance with laws and regulations included in this report.

### **Leadership**

69. Management did not adequately respond to the AGSA's message as they did not effectively discharge their oversight responsibilities to ensure an improvement in the audit outcome.

70. The leadership did not always take timely and adequate action to address weaknesses in the finance and supply chain management directorate due to lack of monitoring and supervision, which resulted in non-compliance with applicable legislation and gave rise to irregular expenditure. The lack of timely action from leadership in instances relating to the discharging of untreated effluent to the oxidation ponds of the water treatment plant could expose the general public to environmental and health issues and may lead to claims against the municipality.
71. Leadership did not continually implement preventive measures to address weaknesses in the control environment to promote ethical values and good governance that protected and enhanced the interests of the municipality. This was identified since there were no processes in place to enable effectiveness of internal controls that ensured reliability and validity of financial information. Poor performance or deviations from the expected standards of conduct were not followed up to ensure that remedial or disciplinary action was taken in a timely and consistent manner. Overriding of internal controls resulted in a high number of instances of irregular and fruitless and wasteful expenditure where value for money was not always obtained, which resulted in potential cases of fraud that need to be investigated by management. Although this matter was raised in the prior year as well, these matters have still not been investigated.
72. Consequence management was not effective as the council did not investigate instances of unauthorised, irregular and fruitless and wasteful expenditure to determine whether any person was liable for the expenditure as the council neglected to appoint a committee to investigate the expenditure.

## **Financial and performance management**

73. Proper record keeping, during the current and previous year's audits, was not implemented in a timely manner to ensure that complete, relevant and accurate information was accessible and available to support financial and performance reporting, as management did not monitor to determine whether the controls were implemented effectively. As a result, significant difficulties were experienced in respect of the availability of information.
74. Effective performance systems, processes and procedures as well as the management thereof had not been adequately developed and implemented due to a lack of capacity.
75. The financial statements were not properly reviewed for completeness and accuracy prior to submission for auditing due to a lack of skilled staff.
76. Ongoing monitoring and supervision were not undertaken to enable an assessment of the effectiveness of internal control over financial and performance reporting due to the fact that the accounting officer and chief financial officer positions were filled in an acting capacity for most of the financial year. Internal control deficiencies were therefore not identified, communicated and corrected in a timely manner.
77. Management also did not establish effective monitoring and evaluation components or processes within its finance and strategic planning directorates to regularly review and monitor management's compliance with laws and regulations and internally designed policies and procedures due to capacity problems. As a result, significant non-compliance issues were noted that could have been prevented.

## Governance

78. The implementation of external audit recommendations was not prioritised and also not monitored, with the result that in the prior year audit findings were not addressed.
79. As a result of inadequate support by management to the functioning of the internal audit unit, the audit committee could not adequately promote accountability and service delivery by evaluating and monitoring responses to risks and overseeing the effectiveness of the internal control environment, including financial and performance reporting and compliance with laws and regulations.

*Auditor-General*

Bloemfontein

30 November 2015



AUDITOR - GENERAL  
SOUTH AFRICA

*Auditing to build public confidence*